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Supreme Court of the United States

October Term, 1925.

No. 272.

ANDREW W. MELLON, Director General and Agent (Substituted in place of James C. Davis),
Appellant-Petitioner,

v.

MICHIGAN TRUST COMPANY, Receiver of Rathbone Manufacturing Company,
Respondent.

On Certiorari to the United States Circuit Court of Appeals for the Sixth Circuit.

BRIEF IN BEHALF OF APPELLEE-RESPONDENT.

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BRIEF IN BEHALF OF APPELLEE-RESPONDENT.

STATEMENT OF THE CASE.

We regard the statement of the case as set forth in brief for appellant-petitioner as adequate and sufficient for an understanding of the questions involved, and therefore proceed at once to the argument.

ARGUMENT.

The Priority Statute.

The *Priority Statute, Section 3466 of the Revised Statutes of the United States,* provides:

> "Whenever any person indebted to the United States is insolvent, or whenever the estate of any deceased debtor, in the hands of the executors or administrators, is insufficient to pay all the debts due from the deceased, the debts due to the United States shall be first satisfied; and the priority hereby established shall extend as well to cases in which a debtor, not having sufficient property to pay all his debts, makes a voluntary assignment thereof, or in which the estate and effects of an absconding, concealed, or absent debtor are attached by process of law, as to cases in which an act of bankruptcy is committed."

When the writ of certiorari in this case was granted on April 13, 1925 *(45 Sup. Ct. Rep., 507),* it was an open question in this court whether the acts done by the debtor, Rathbone Manufacturing Company, in this case made it one "in which a debtor, not having sufficient property to pay all his debts, makes a voluntary assignment thereof," or one "in which an act of bankruptcy is committed," within the meaning of the Priority Statute.

This question is now apparently closed against further argument by reason of the decision of *United States v. Butterworth-Judson Corporation, 46 Sup. Ct. Rep., 179* (decided January 11, 1926). This court there held, under facts similar to this case, that a corporation in fact insolvent, but not alleged nor admitted to be so, which admits the allegations of a creditor's bill setting forth its inability to meet maturing obligations, and consents to the appointment of a receiver, thereby hands over its property and business to the receiver to be administered as a trust fund to pay its debts, and in effect makes a voluntary assignment of all its property within the meaning of Section 3466.

This brings us to the only remaining question covered by the assignments of error in this case, namely, whether Section 10 of the Federal Control Act of March 21, 1918 (40 Stat., C. 25, 451, 456) prevents the Director General from asserting government priority over other creditors on claims arising out of the governmental war operations of the railroads.

The Director General Is Not Entitled To Assert Government Priority.

Section 10 of the Federal Control Act (40 Stat., C. 25, 451, 456, Act of March 21, 1918) provides:

> "Carriers, while under federal control, shall be subject to all laws and liabilities as common carriers, whether arising under state or federal laws or at common law, except insofar as may be inconsistent with the provisions of this act or any other act applicable to such federal control or with any order of the president. Actions at law or suits in equity may be brought by and against

> such carriers and judgments rendered as now provided by law; and in any action at law or suit in equity against the carrier, no defense shall be made thereto upon the ground that the carrier is an instrumentality of agency of the federal government. Nor shall any such carrier be entitled to have transferred to a federal court any action heretofore or hereafter instituted by or against it, which action was not so transferable prior to the federal control of such carrier; and any action which has heretofore been so transferred because of such federal control or of any act of congress or official order or proclamation relating thereto shall, upon motion of either party, be retransferred to the court in which it was originally instituted. But no process, mesne or final, shall be levied against any property under such federal control."

In reaching its conclusion that Section 10 of the Federal Control Act prevented the Director General from asserting government priority in respect to claims arising out of the operation of the railroads during federal control, the court below said, *2 Fed. (2nd), 194, 197* (R., pp. 27-28):

> "It seems to us clear that this section was intended to subject the Director General in the operation of the various railway systems to the same rules of substantive civil law that had theretofore applied to the carriers. To give the Director General with his manifold claims arising in the ordinary course of business, priority over all other creditors may work grave injustice. In some cases it might result in the Director General's taking all or nearly all the assets of the debtor. Such priority would give to the Director General a special and privileged position quite inconsistent with the underlying principles of the Federal Control Act; *Director General v. Kasten-*

baum, 263 U. S., 25; Davis v. McCree, 299 Fed., 142, 146 (C. C. A., 6); and the marked tendencies of our public law; cf. *The Pesaro, 277 Fed., 473; The Gloria, 286 Fed., 188.* Judicial opinion as well as legislation is examining anew the proper privileges and immunities to be accorded the sovereign state, and in cases not clearly covered by statute or decision the correct solution is not to be found by the application of an abstract or formula but by the most careful consideration of the public needs and the practical requirements of law in the modern industrial community.

Giving due regard to the expression of congressional policy of priority, on the one hand, and of a restriction to the rights that the carrier theretofore enjoyed, on the other hand, and on a careful balancing of conflicting interests, we believe that, especially in the light of the policy of the present Bankruptcy Act as interpreted by the Chief Justice *(supra)*, priority must be denied to the Director General in this case."

In speaking of "the policy of the present Bankruptcy Act as interpreted by the Chief Justice," the court is referring to the case of *Sloan Shipyards v. U. S. Fleet Corporation, 258 U. S., 549,* in which the majority of the court denied priority in a bankruptcy proceeding set up by the Emergency Fleet Corporation, on the ground that, even if the United States would be entitled to priority, the Emergency Fleet Corporation was a separate entity, and its claim for priority could not be sustained. The majority intimated no opinion on the question whether a debt to the United States other than for taxes would have been entitled to priority. The Chief Justice and Justices Van Devanter and Clarke dissented from the reasoning of the majority, but as to the claim to priority concurred in the result in this langauge used by the Chief Justice:

> "As to the preference claimed against a bankrupt in No. 526 by the Fleet Corporation, I concur in the conclusion of the court that it cannot be allowed under the statute as to preferences in bankruptcy, because I do not think it extends to claims of the United States except those for taxes."

It is significant that the view taken in this case by the Chief Justice and Justices Van Devanter and Clarke was later adopted by the entire court in *Davis, Federal Agent, v. Pringle, 45 Sup. Ct. Rep., 549* (May 25, 1925), where the court held that claims due the United States other than taxes are not entitled to priority under the present Bankruptcy Act.

Mr. Justice Holmes, in speaking for the court, said, page 550:

> "Public opinion as to the peculiar rights and preferences due to the sovereign has changed. We agree with the view of this point taken by the Chief Justice and Justices Van Devanter and Clarke in *United States Shipping Board Emergency Fleet Corporation v. Wood, 258 U. S., 549, 574; 42 S. Ct., 386; 66 L. Ed., 762*, at a time when it was not necessary for the majority to speak upon it. The priority claimed by the United States is not given to it by the law."

This reasoning and conclusion adds new emphasis to the observation of the Circuit Court of Appeals in the instant case, that "judicial opinion as well as legislation is examining anew the proper privileges and immunities to be accorded the sovereign state," and thus confirms its decision that the Director General should be denied the right to assert government priority.

Section 10 of the Federal Control Act was not involved in either *United States v. Butterworth-Judson Corporation, 46 S. Ct., 179* (January 11, 1926); or in *Bramwell v. United States Fidelity & Guaranty Co., 46 S. Ct., 176* (decided the same day), or in *Price v. United States, 46 S. Ct., 189* (decided the same day). In the first case the claim of the government was for breach of a war contract for the manufacture of picric acid *(United States v. Butterworth-Judson Corporation, 297 Fed., 971 (C. C. A., 2); 45 S. Ct., 338; 267 U. S., 387).* In the *Bramwell case*, the claim was made by the bonding company as assignee of the United States under a bond given by the bank to the United States to secure the payment of a deposit made by the superintendent of an Indian reservation. In the *Price case* the government's claim was for income taxes and unpaid customs duties. None of these cases therefore have any bearing upon the rights of the Director General in a claim arising out of the government operation of railroads.

It is recognized by the Circuit Court of Appeals in the present case that its conclusion on the point under discussion differs from that expressed in *In Re Hibner Oil Co., 264 Fed., 667 (C. C. A., 7); In Re Tidewater Coal Exchange, 280 Fed., 648 (C. C. A., 2); Davis v. Pullen, 277 Fed., 650 (C. C. A., 1); and Davis v. Miller-Link Lumber Co., 296 Fed., 649 (C. C. A., 5).*

It is pointed out, however, that "in none of these cases does the court's attention appear to have been drawn to Section 10 of the Federal Control Act."

In *In Re Hibner Oil Co.* and *In Re Tidewater Coal Exchange*, claims were for unpaid freight charges for shipments by railroad under federal control and were

held entitled to priority under Bankruptcy Act, Section 64-b (5) and Section 3466, Revised Statutes, without discussion of Section 10 of the Federal Control Act. Section 10 likewise received no discussion in *Davis v. Miller-Link Lumber Co.*, where a claim for trackage charges was held entitled to priority. In *Davis v. Pullen*, freight charges were held entitled to priority without discussion of Section 10. It is noteworthy that in the *Pullen case* the court admitted the weight of the argument, that the enterprise of the government under its war powers in taking over and operating the railroads, was not within the contemplation of congress in enacting the Priority Statute, and recognized the injustice of allowing priority in such a case *(277 Fed., 650, 655)*:

> "This argument has weight. There is a certain obvious injustice in giving the United States when engaged in an industrial and commercial venture, even though under war powers, superior rights over other creditors bearing like relations to the insolvents."

In other decisions where Section 10 of the Federal Control Act has been interpreted in cases involving matters of "civil, compensatory law" (of which the instant case is typical), the view is consistently adhered to that the act is to be regarded as subjecting the Director General to the same rights and liabilities that existed as to common carriers before its enactment.

In *Director General v. Kastenbaum, 263 U. S., 25*, it was held in an action against the Director General for false imprisonment:

> "The government under Section 10 in a case of false imprisonment, stands exactly as if it were

a railway corporation operating as a common carrier."

In *Wilson & Co. v. Davis, Director General, 8 Fed. (2nd), 484 (C. C. A., 7, October, 1925)*, the court held that the plaintiff, a shipper, was entitled to interest on a reparation award made by the Interstate Commerce Commission on excessive freight charges collected during federal control, but was not entitled to costs and attorneys' fees, as the latter was not an item of damage while the former had been uniformly allowed and recovered before the Transportation Act was enacted. The court said, after quoting Section 10 of the Federal Control Act and Section 206 of the Transportation Act:

> "A fair interpretation of these statutes, we think, demands a construction which continued (so far as possible) all existing rights, liabilities and obligations of shippers and carriers."

Of like import are *Wyoming Sugar Co. v. Davis, 7 Fed. (2nd), 622 (D. C. Wyo., August 15, 1925)*, and *Empire Refining Co. v. Davis, Director General, 6 Fed. (2nd), 305 (D. C. Okla., March, 1925)*.

It is true that in *DuPont De Nemours & Co. v. Davis, 264 U. S., 456*, and *Davis v. Corona Coal Co., 265 U. S., 219*, this court held that in taking over and operating the railroad systems of the country the United States did so in its sovereign capacity, but we submit that the right of the Director General to assert government priority is not thereby established. It has long been settled that in a case of this kind where the government is asserting priority in payment of debts (not taxes), the right of priority depends exclusively upon the statute and does not rest upon any general

prerogative belonging to the government in its sovereign capacity. The right to priority in this country is not an attribute of sovereignty but is a creature of statute. In *United States v. Canal Bank, 25 Fed. Cas., pages 277, 278; 3 Story 79*, Mr. Justice Story, sitting in the circuit court in 1844, said:

> "In the first place, whether the United States have any priority, or privilege, in respect to the debts due to them by their debtors, over the debts due to private persons, so as to entitle them to a prior satisfaction, upon any judgments obtained against their debtors, out of the property attached, before other attaching creditors, whose attachments are of an earlier date. * * * It has long since been settled, by the solemn adjudications of the supreme court, that the United States do not possess any general right of priority or privilege over private creditors, for the satisfaction of the debts due to them, founded upon any general prerogative, belonging to the government in its sovereign capacity, but that all the priority or privilege, which the government is at liberty to assert, is or must be founded upon some statute, passed by congress, in virtue of its constitutional authority. This was expressly so held in *U. S. v. Fisher, 2 Cranch (6 U. S.), 358, 396 (2 L. Ed., 304)*, and the doctrine has ever since been strictly adhered to. *U. S. v. Hooe, 3 Cranch (7 U. S.), 73 (2 L. Ed., 370); Prince v. Bartlett, 8 Cranch (12 U. S.), 431 (3 L. Ed., 614); Thelusson v. Smith, 2 Wheat. (15 U. S.), 396 (4 L. Ed., 271); U. S. v. Howland, 4 Wheat. (17 U. S.), 108 (4 L. Ed., 526); Conard v. Atlantic Ins. Co., 1 Pet. (26 U. S.), 387 (7 L. Ed., 189).* It is not here, as it is in England, where the sovereign is entitled, in virtue of his prerogative, to a priority over private creditors, for satisfaction of the debts due to the crown. *Com. Dig. 'Prerogative,' D. 86; Id. 'Debt,' G. 8, G. 9.*"

In *United States v. Oklahoma, 261 U. S., 253, 259; 43 S. Ct., 295 (67 L. Ed., 638):*

> "The claim of the United States to the asserted priority rests exclusively upon the statute."

In *Price v. United States, 46 S. Ct., 180* (decided January 11, 1926), Mr. Justice Butler said:

> "The claim of the United States does not rest upon any sovereign prerogative." * * *

Thus, on the question of priority, it becomes immaterial whether, as stated in *DuPont De Nemours & Co. v. Davis, 264 U. S., 456,* the government in taking over the operation of the railroads of the country, did so in its sovereign capacity. The question depends solely upon the language of the Priority Statute and that of Section 10 of the Federal Control Act.

It is clear that at the time of the decision in *Davis v. Pringle, 45 S. Ct., 549* (May 25, 1925), this court did not consider that the question of the Director General's right to priority had been settled by any of its previous decisions. Three cases were there before the court on writs of certiorari, two of them involving claims for freight, storage and demurrage charges of the Director General accruing in the operation of railroads under federal control, which claims were proved in bankruptcy proceedings by the federal agent and for which priority was asserted on the ground that they were debts due to the United States of the character given priority by Section 3466. The court found that by reason of the Bankruptcy Act, the government was not entitled to priority, leaving undecided the question of the right of the Director General to assert government priority and indicating that the latter question would require additional inquiries:

> "All the three cases depend upon the question whether the government has a right to the priority it claims. If that is denied the additional inquiries that would be necessary before the federal agent could prevail in the railroad cases need not be gone into. Therefore we take up that first."

We think it is not an unwarranted assumption that the further statement of Mr. Justice Holmes in that case that "*public opinion as to the peculiar rights and preferences due to the sovereign has changed*" has a significance beyond its application to the case there under consideration.

CONCLUSION.

We submit that the language of Section 10 of the Federal Control Act and the policy it was plainly designed to express, the obvious injustice that would result to other creditors if the Director General were given the privileged position of a preferred creditor, and the drift of public sentiment away from an enlargement of the rights and privileges of the sovereign, are all valid reasons why the judgment of the lower court was correct, and we respectfully submit that its decision denying priority should be affirmed.

Respectfully submitted,

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